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INTERCO

1981 Annual Report

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Contents Page

INTERCO 70th Anniversary

History of INTERCO

To trace the history of INTERCO one must look back more than 70 years.

Roberts, Johnson & Rand Shoe Company was a footwear jobber organized in St. Louis in 1898 by Jackson Johnson, Oscar Johnson, Edgar E. Rand and John C. Roberts. *Peters Shoe Company*, which had been organized in St. Louis in 1891 by Henry W. Peters, was engaged in manufacturing and wholesaling footwear.

Those two companies had been competitors and, though they were different types of firms, their policies, ideals and business standards were so closely allied that they were drawn together by a wholesome respect for one another. Their respective leaders saw great opportunities from a possible combination of the two companies, increased economies in manufacturing and distribution, coupled with maintenance of their high standards, and a potential for increased sales.

In 1911, without submerging the individuality of either company, *Roberts, Johnson & Rand Shoe Company* and *Peters Shoe Company* were merged to form *International Shoe Company*.

International Shoe Company purchased *Friedman-Shelby Shoe Company*, another St. Louis-based shoe manufacturer in 1912. It, too, became part of *International Shoe Company* without loss of its original identity and individuality.

The company was reorganized under Delaware law in 1921, and the stockholders of the 1911 Missouri corporation exchanged their stock for stock in the new Delaware corporation.

During the next 40 years, *International Shoe Company* grew to a large, vertically integrated, shoe manufacturer and, in 1953, acquired The *Florsheim Shoe Company*, a premier manufacturer of men's shoes with a budding, company-owned, retail business. That was followed shortly thereafter by the acquisition of *Senack Shoes, Inc.*, an operator of leased shoe departments. True to the tradition established upon the founding of the company — 50 years before — *Florsheim*, *International Shoe* and *Senack* each operated autonomously and, together, they constituted the world's largest shoe manufacturer.

In 1964, the company began a diversification program with the acquisition of general retail and apparel manufacturing businesses and, in 1966, the separate INTERCO staff was formed and the corporate name was changed to INTERCO INCORPORATED to reflect more accurately the company's diversified operations. The retail and apparel acquisitions continued during the late 60's and throughout the 70's. In 1980, manufacturing and distribution of furniture and home furnishings was added.

INTERCO Today

INTERCO is a broadly based major manufacturer and retailer of consumer products and services represented by four operating groups.

Apparel Manufacturing Group consists of 11 apparel companies operating 64 manufacturing plants and 13 major customer distribution centers across the country. The group designs, manufactures and distributes a full range of branded and private-label sportswear, casual apparel, outer garments and headwear for men and women. Distribution is national in scope to department stores, specialty shops and other retail units. Substantial distribution, under private and branded label, is also made to large national retail and discount chains.

General Retail Merchandising Group operates 868 retail locations in 28 states in this country, offering to the consumer a large assortment of popular-priced products and services. General retailing includes junior department stores, discount stores, men's and women's specialty apparel shops, specialty department stores and large do-it-yourself home-improvement centers. Ten modern regional distribution centers support these retail locations.

Footwear Manufacturing and Retailing Group operates 929 retail shoe stores and leased shoe departments in 42 states in this country, as well as in Australia, Canada and Mexico. The group also styles, manufactures and distributes, primarily, men's footwear in most major price ranges in the United States, Canada and Australia. There are 19 shoe manufacturing plants and four major distribution centers in operation.

Furniture and Home Furnishings Group manufactures and distributes quality furniture and home furnishings. There are 45 factories and 12 major distribution centers and consolidation warehouses located throughout the United States. The company also owns and operates 28 Showcase Galleries and accessory stores.

Highlights

Years Ended	February 28, 1981	February 29, 1980	Change
From operations:			
Net sales	**$2,368,456,000**	$2,024,307,000	+ 17.0%
Earnings before income taxes	**238,117,000**	205,735,000	+ 15.7%
Net earnings	**124,330,000**	106,706,000	+ 16.5%
As a percent of sales	**5.2%**	5.3%	
Per share of common stock:			
Earnings	**$7.61**	$7.35	+ 3.5%
Dividends	**$2.64**	$2.35	+ 12.3%
Financial condition at year end:			
Working capital	**$ 714,678,000**	$ 606,833,000	+ 17.8%
Current ratio	**3.7 to 1**	3.5 to 1	
Total assets	**1,469,137,000**	1,239,036,000	+ 18.6%
Stockholders' equity	**914,000,000**	836,313,000	+ 9.3%
Book value per common share	**$57.98**	$52.21	+ 11.1%
Return on stockholders' average investment	**14.3%**	14.6%	
Shares outstanding at year end:			
Common	**14,013,583**	14,156,019	
Preferred	**1,014,399**	972,376	
Number of stockholders	**15,500**	16,000	
Number of employees	**56,000**	50,000	

To Our Stockholders

Despite the many economic problems facing U.S. businessmen in fiscal 1981, INTERCO was able to perform above average and recorded its seventeenth consecutive year of record sales, earnings and earnings per share. At the same time, our financial condition grew even stronger and we are well positioned to take advantage of the opportunities of the 1980's.

As we celebrate our 70th anniversary, sales in fiscal 1981 were $2.37 billion — an increase of 17.0%, net earnings were $124.3 million — an increase of 16.5%, and earnings per common share, fully diluted, were $7.61 — an increase of 3.5%. Because of the increase in the number of average common stock equivalents outstanding, per share earnings did not rise as rapidly as net earnings.

In fiscal 1981, we continued our program of expansion and growth through the addition of *Broyhill Furniture Industries, Inc.* This outstanding company will make our newly formed fourth business group — Furniture and Home Furnishings — an important part of our plans, because it will offer INTERCO growth opportunities in a new market. On December 8, 1980, Paul H. Broyhill, Chairman of the Board and Chief Executive Officer of *Broyhill Furniture Industries, Inc.*, was elected a member of the INTERCO Operating Board and he will continue, along with other management executives at *Broyhill*, to be responsible for the operations of this business.

In line with our planned future succession, three of our executives were elevated to new positions, effective March 1, 1981.

1. John K. Riedy, formerly President and Chief Operating Officer of your company, was elected Vice Chairman of the Board of INTERCO.
2. Harvey Saligman, formerly President of *Queen Casuals, Inc.*, an INTERCO company, was elected President and Chief Operating Officer of your company.
3. Ronald L. Aylward, formerly Vice President and General Counsel, was elected Executive Vice President, Administrative, of your company.

These changes are part of your management's planning for the future.

Cash dividends on the company's common stock were increased in March 1981, by 9.1% to an annual rate of $2.88 per share. The company has paid quarterly cash dividends on its common stock for seventy consecutive years. Your Board of Directors will continue to make frequent reviews of the dividend rate in relation to the experienced growth of the company.

On page 51 of this annual report we pay tribute to Dude Chambers who is retiring as an officer and director after many years of faithful service to our stockholders. We will miss his guidance and his dedication to the company.

As we approach fiscal 1982 we will continue to use the same conservative attitude as we had one year ago. We continue to be concerned about the effects of climbing inflation, consumer attitude, severe cost pressures on our

William L. Edwards, Jr.

businesses and the serious challenges facing the present economy. In recent weeks there have been a few trends that would suggest a more optimistic outlook during the next twelve months, therefore, we plan to evaluate carefully our various market opportunities in order that we will have the ability to carry out any changes in our business plan as a result of our day-by-day awareness of our business. As we have demonstrated in the past, your company offers great opportunities for long term growth and we are determined to take advantage of these opportunities because:

- We do have proven management at each operating company with a good track record,
- We do have management dedicated to the philosophy of your company and its management disciplines,
- We do have a very strong financial condition, and
- We do have the ability to employ cost control programs and to carry out profit improvement programs.

We have previously reported that our management places great importance on people, together with constant communication within the entire organization. As a result, our monthly Operating Board meeting includes a review of budgets, forecasts, inventory and accounts receivable control,and other areas concerned with managements operating philosophy.

We enter fiscal 1982 in a very strong financial position with consumer products and services directed toward the customer demands for quality and value.

I wish to thank our loyal and conscientious employees for their efforts during the past year. We also wish to thank our customers for making it all possible, and our stockholders for their continued support and confidence.

In our 70th anniversary year we look forward with great confidence to the future growth of INTERCO.

W. L. Edwards Jr.

Chairman of the Board and
Chief Executive Officer

April 13, 1981

Broyhill joins INTERCO

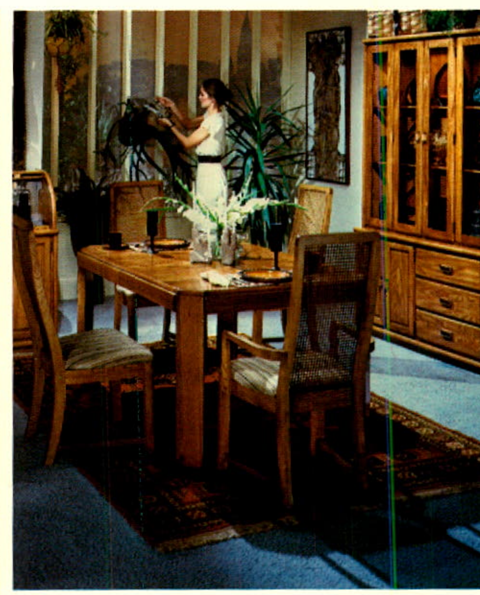
Broyhill Furniture Industries, Inc. joined INTERCO and its recently formed Furniture and Home Furnishings Group on December 1, 1980.

Founded in 1926, with $5,000 initial capital, and utilizing a rented two-story building hardly larger than a residence, *Broyhill* has developed into a company with sales of more than a quarter of a billion dollars, in just 55 years. Today, *Broyhill* is the third largest manufacturer and distributor of household furniture in the United States. Prior to joining INTERCO, *Broyhill* was recognized as the largest privately owned furniture company in the world.

As a major manufacturer of a diverse line of household furniture, *Broyhill* products, sold under the *Broyhill* name, include: a large and varied selection of wood and wood veneer bedroom and dining room furniture; upholstered living room furniture available in many styles, fabrics and colors; and a wide collection of occasional and casual furnishings.

Concentrated in the medium price ranges, *Broyhill's* product lines are the most extensive in the furniture industry and include all the popular styles such as Early American, English, traditional, French, Italian, and contemporary.

Broyhill's brand name products are widely recognized and accepted by homemakers as evidenced by the more than 10,000 dealers who sell *Broyhill* furniture throughout the United States and many foreign countries. The company employs a sales force of over 200 persons that markets *Broyhill* products exclusively.

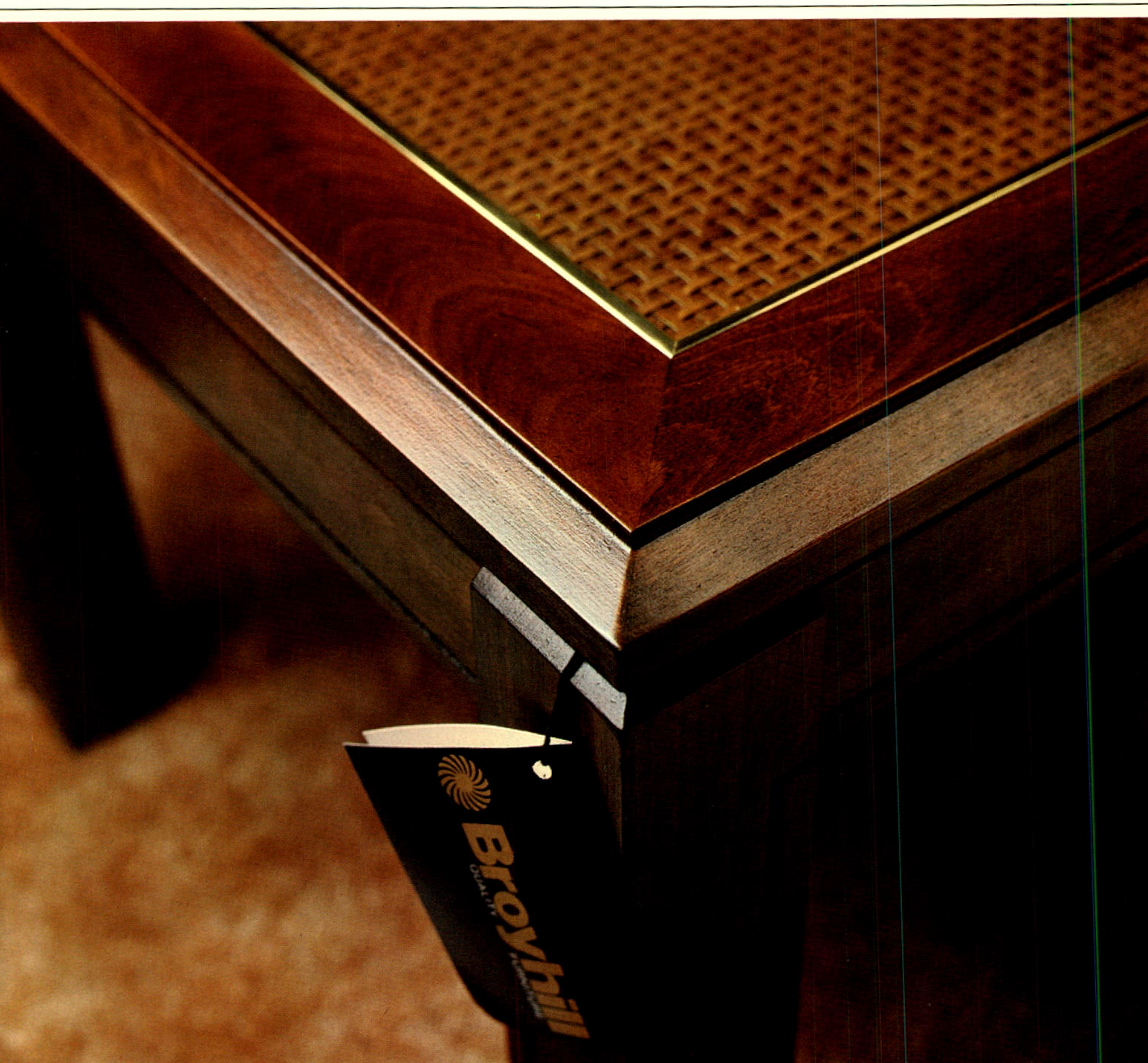


The company is headquartered in a large, modern, impressive three-story building in Lenoir, North Carolina. Nearly one half of the floor space is set aside as a permanent showroom, with an ever-changing decor, and is recognized as one of the prominent furniture showrooms in the South.

Long recognized as an innovator of furniture manufacturing techniques, *Broyhill's* manufacturing facilities are among the most modern and efficient in the industry. Centered in the heart of the lumber industry, *Broyhill* operates 17 plants within a 50-mile radius of its corporate headquarters and one plant in each of the states of South Carolina, Louisiana and Texas. Operations utilize approximately six million square feet of floor space. The company maintains its own engineering and design department which, in addition to developing new techniques and systems, constantly seeks out and tests superior manufacturing equipment developed by others. The company is unique among furniture manufacturers in that it produces most of its own particle board requirements utilizing scrap lumber and other wood wastes.

Approximately 7,500 persons are employed by *Broyhill* in all facets of its business. The company is structured into four major manufacturing operating groups — bedroom division, dining room division, upholstery division, and occasional and casual furniture division. All advertising materials are developed in-house by company personnel and furnished to retailers throughout the country. *Broyhill* has intensive personnel training programs at all operating levels and has long been recognized as a leader in programs for management.

The addition of *Broyhill* to the Furniture and Home Furnishing Group, established through the acquisition of *Ethan Allen* in January 1980, makes INTERCO the largest manufacturer of furniture in the world.


Broyhill

Major Apparel Brands for Women and Young Women: *Clipper Mist* *College-Town* *Devon* *Fog* *Gateway Casuals* *It's Pure Gould* *Lady Devon* *Lady Queen* *London Fog* *Maincoats* *Outdoors Unlimited* *Pant-her* *Petite Concept* *Queen Casuals* REJOICE!® *Stuffed Jeans* *Stuffed Shirt* *Travelaire*

Apparel Manufacturing Group

The Apparel Manufacturing Group had record results in sales and operating earnings in fiscal 1981. Sales were $851.0 million or 35.9% of the consolidated sales and operating earnings were $109.8 million or 42.1% of the operating earnings of the company, for a return on sales before income taxes, corporate expenses and interest cost of 12.9%. Sales increased 4.0% and operating earnings rose by 3.7%.

The record results were accomplished during a sluggish economy in which our customers — department stores, specialty shops and retail chains — became more selective in their buying, seeking value, quality and durability. With an increasing number of women entering or returning to the work force, our lines of coordinated apparel — skirts, slacks and jackets — continue to do well in the marketplace. The trend is toward the "dressed up" look for the professional woman and INTERCO's widely-accepted lines of branded merchandise appeal to all women.

Market acceptance of our petite lines has been enhanced by the trend of retailers to establish separate departments for the smaller woman, those 5'4" and under. The junior, missy and larger size classic lines have remained an important part of our business.

Outerwear sales were at record levels with the *London Fog* trademark maintaining its prestigious position in the marketplace. The *Outdoors Unlimited by London Fog* collection of rainwear and outerwear, for the active lifestyle, is growing rapidly.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Major Apparel Brands for Men and Young Men:

Big Yank *Biltwell* *Campus* *Clipper Mist* *Cowden* *Donegal* *Esprit by Campus* *Gateway Casuals* *John Alexander* *Leonard Macy* *Le Tigré* *London Fog* *Mr. Golf* *Mr. Tennis* *Maincoats* *Outdoors Unlimited* *Pro-action* *Rugged Country* *Startown* *Studio One by Campus* *Tailor's Bench* *Tour de France* *Travelaire*

Continuing popularity of western wear has benefited our operations. Western hats, which traditionally sold well in the West and Southwest regions of the country, are now in demand throughout the country. Western style shirts, jeans and outerwear sales were aided by the trend toward casual living apparel. Spring orders for these lines have been at record levels.

Casual sportswear lines also performed well during the year. The collection of *Le Tigre'* apparel has become an important part of the *Campus* line. This collection has been expanded from the initial mesh knit shirt to include related active wear, blazer sportcoats, slacks, sweaters, outerwear and sport shirts.

Increasing emphasis is being placed on selected advertising programs to enhance consumer awareness of branded lines. These programs will be presented on television, as well as through the print media.

During the year, we added three plants and closed one plant in addition to expanding our distribution facilities. Projects for fiscal 1982 include the addition of one plant, the relocation of two plants and the relocation and enlargement of an existing distribution center, thus continuing our program of modernization of facilities.

INTERCO's apparel for women is designed for the petite, junior, missy and large size markets. Our products include suits, dresses, pants, skirts, jackets, sweaters, blouses, shirts, T-shirts, vests, blazers, jeans, headwear, rainwear and outerwear.

Our products for men include sport, knit and dress shirts, sweaters, sport coats, blazers, suits, outerwear, rainwear, headwear, jeans, slacks, swimwear and walk shorts.

Through aggressive export activities and licensing programs, the value, style and quality of our products are becoming known to consumers in many countries.

Fiscal 1982 will be a difficult year with interest rates and inflation remaining at abnormally high levels. Retailers will continue to look for merchandise which will stimulate the consumers. With the western look for casual living and the dressed up look for business life remaining strong, we enter the new year with a feeling of cautious optimism.


campus
Le TIGRE


London Fog

Major Retail Trading Names: *Alberts Albert K Alcove Central Hardware Carithers Hirsch Value Center Eagle Family Discount Stores Fine's Golde's Jeans Galore Idaho Department Store Keith O'Brien Kent's Miller's P. N. Hirsch Shainberg's Sky City Discount Center Standard Sportswear Thornton's United Shirt Wigwam*

General Retail Merchandising Group

Sales of the General Retail Merchandising Group were at a record level for fiscal 1981. Operating earnings, however, were affected by above normal mark-downs and heavy promotions.

Sales were $645.9 million or 27.3% of the consolidated sales and operating earnings were $27.3 million or 10.5% of the consolidated operating earnings of INTERCO, for a return on sales before income taxes, corporate expenses and interest cost, of 4.2%. The sales increase amounted to 2.5% while operating earnings were down 33.7% from the prior year.

During the year, 46 new stores were added and 34 closed, increasing the total to 868 at year end. The plan for the current year includes the opening of approximately 25 new stores.

The General Retail Merchandising Group includes the following retail companies:

- *Central Hardware* set an all time high in store openings with two in Columbus, Ohio, two in Memphis, Tennessee, and replacement of an older store in St. Louis with a new and larger facility. Also during the year, *Central* completed the expansion of its distribution center in St. Louis and continued its policy of updating older facilities with major remodeling projects in St. Louis and Memphis. At year end, *Central* had 29 large home improvement centers serving the do-it-yourself homeowner. A move into the Kansas City market is planned for fiscal 1982 with construction expected to start on two stores by midyear.


Standard Sportswear


P.N. HIRSCH & CO.


51354640
PRICE CHANGE
CLEAR
ITEM CORRECT
TOTAL
MODIFY TAX
SUB TOTAL
ENTER
MasterCard

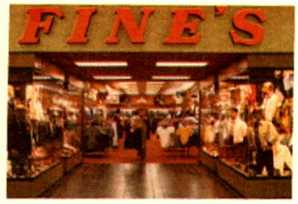

domestics

- *Eagle Family Discount Stores* and *Sky City Stores* operate a total of 285 convenience discount stores located in the Southeastern part of the country. Consumers today are price conscious, and the marketing strategy of INTERCO's two convenience chains is to offer an increasing selection of private-labeled and branded merchandise at low, discounted prices.
- *Fine's, Standard* and *United*, INTERCO's chain of 80 men's specialty apparel shops, located in the Mid-Atlantic states, Pennsylvania, Ohio and Michigan, introduced a program during the year of providing the retail consumer with desirable in-demand merchandise at promotional price levels. This program has been enthusiastically received by our customers and has resulted in increased traffic in our shops.
- *Alberts* operates a Midwestern chain of 79 specialty stores for women under the name of *Alberts* and *Albert K*, offering nationally advertised merchandise for the contemporary woman, and *Alcove* featuring boutiques for today's trendier young woman. *Alberts'* target customer is today's career oriented, working woman who demands quality merchandise at affordable prices offered in an attractive, easy-to-shop environment. It continues to be *Alberts'* objective to most effectively capture the career woman's attention, and make *Alberts* her place to shop through store locations, merchandise selection, service, promotions and advertising.
- P. N. *Hirsch & Company*, a chain of 385 junior department stores, continued during the year to upgrade many of its existing stores and to move into larger and more modern and desirable locations, particularly in the Midwest. Consumer attitudes are very much back to basics, with customers looking for better values to justify rising prices.
- *Golde's*, headquartered in St. Louis, opened two additional stores during the year bringing the total number of specialty department stores to ten. *Golde's* has added a gift/housewares department in a number of their stores which has been highly successful. Service and helpful guidance, along with quality merchandise and good value, continues to be the company's commitment.

Retail business today requires more promotions and special pricing in order to stay competitive and attract the interest of the consumer. INTERCO's General Retail Merchandising Group looks forward to an improved performance in the coming year.


EAGLE
FAMILY DISCOUNT STORES


UNITED SHIRT


FINE'S


Central Hardware's
MASTER SERVICE

Major Footwear Brands: For Men: *Ambassador Florsheim Florsheim Imperial Royal Imperial by Florsheim City Club Idlers by Florsheim Weeds from Florsheim Grizzlies Hy-Test Julius Marlow Rand Roberts Winthrop Worthmore* **For Women:** *Crawdads diVina Florsheim Miss Wonderful Personality Thayer McNeil Vitality*

Major Retail Trading Names: *Florsheim Shoe Shops Florsheim Thayer McNeil Duane's Miller Taylor Phelp's Thompson, Boland & Lee*

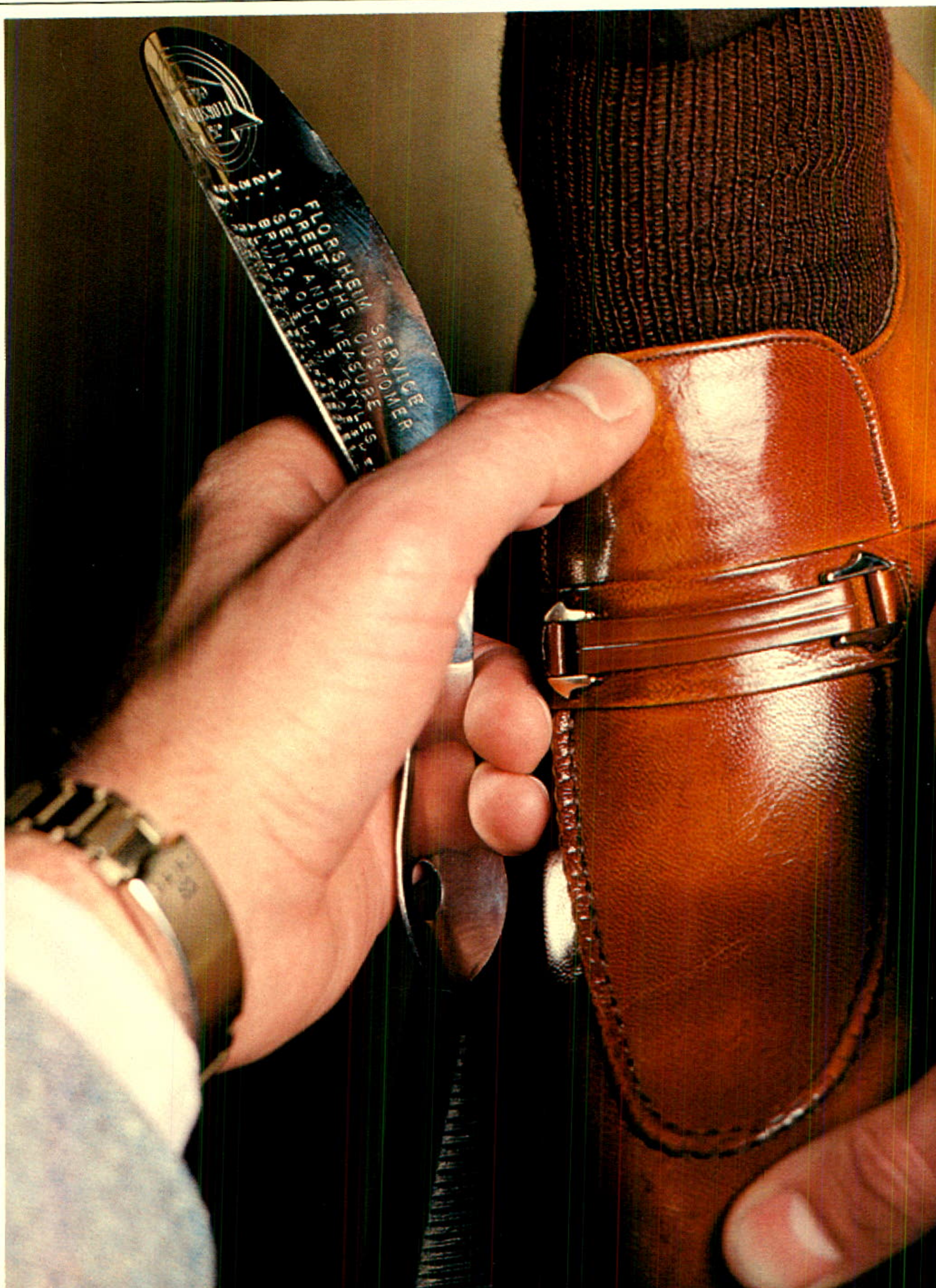
Footwear Manufacturing and Retailing Group

INTERCO's Footwear Manufacturing and Retailing Group achieved record results in sales and operating earnings during fiscal 1981. The group contributed $558.3 million or 23.6% of the consolidated sales, and $83.9 million or 32.1% of the operating earnings of the company, for a return on sales before income taxes, corporate expenses and interest cost of 15.0%. The sales increase amounted to 0.6% and the operating earnings gain was 28.2% over one year ago. The modest increase in sales was achieved notwithstanding the sale of the remainder of our Canadian operations which were not affiliated with the men's footwear business.

Over the last five years, the footwear group has consolidated, eliminated or sold operations which did not provide satisfactory returns. During this period, our operating earnings rose from $43.9 million or 9.4% of sales, to $83.9 million or 15.0% of sales. Our capital expenditures during this period were $41.2 million, reflecting our continuing program of modernization of facilities and equipment and expansion of retail stores.

Footwear Manufacturing

Footwear manufacturing continued to improve its operations with the acquisition of new machinery and equipment for the production of quality shoes and boots. With retail inventories being held at reduced levels, our ability to fill orders with a shorter lead time, at competitive prices, enabled us to increase sales.



Fiscal 1981 was a year of consolidation and growth for our manufacturing operations. During the year, we closed three smaller, less efficient plants and transferred the production to existing facilities utilizing advanced technology. These changes resulted in improved efficiency.

As in the Apparel Group, our Footwear Group showed significant gains in the sale of western style merchandise. Western boots, for dress and casual wear, were strong throughout the year, and spring orders indicate that the trend will continue.

Growing consumer demand for classic and traditional clothing for men should provide new growth in the traditional dress shoe area where *Florsheim* is an industry leader. In the casual footwear market, *Idlers by Florsheim* and *Weeds from Florsheim* continue to gain market acceptance.

Florsheim has introduced the RAVELLO® 2000 collection of footwear in both dress and easy living styles, which features an exclusive sole and heel molded in one piece from a molecular substance injected with literally millions of tiny air bubbles. The RAVELLO 2000 sole forms an extremely lightweight, cushiony support — remarkably flexible — and at the same time having the durability for long lasting wear.

International Shoe continues to expand its highly successful line of *Hy-Test* industrial safety shoes, in addition to being a leading producer of branded and private-label footwear. *Hy-Test* introduced a new slip resistant sole called the "*Clincher*."

Footwear Retailing

Footwear retailing had another record year of growth in sales and earnings in fiscal 1981. During the year, we opened 90 new locations and at year end we were operating 929 shoe stores and leased shoe departments after closing or relocating 35 smaller, marginally profitable units. In addition to seeking new locations aggressively, we have remodeled and redesigned existing stores.

Florsheim had an excellent year in its domestic operations, as well as in the Canadian, Mexican and Australian shops. Future expansion will be made in major regional shopping centers and select downtown locations.

To enhance further our ability to properly serve the discriminating consumer, *Florsheim* is conducting management training programs. Managers from the *Florsheim Shoe Shops* for men, *Florsheim Thayer McNeil Shops* for women and men, as well as, the Florsheim Wholesale Dealer Development Program, attend an intensive course designed to familiarize new and present managers with proven and time-tested management techniques.

Senack, principally an operator of leased shoe departments in major department and specialty stores, had a very successful year.

General

Substantial improvement has been made over the last five years in increasing our return on sales. We will continue to review all aspects of the company to maximize profitability, while maintaining or improving the competitive quality and value on which our customer base has been built.


FLORSHEIM SHOES

Major Furniture and Home Furnishings Brands:
Ethan Allen *Broyhill* *Kling* *Restocrat*
Major Retail Trading Names: *Carriage House*
Georgetown Manor *Manor House* *Georgetown*

Furniture and Home Furnishings Group

The Furniture and Home Furnishings Group was formed through the acquisition of *Ethan Allen Inc.*, on January 28, 1980, and *Broyhill Furniture Industries, Inc.*, on December 1, 1980. The operating results of the two companies have been included in the INTERCO consolidated results of operations from their respective dates of acquisition.

For the year ended February 28, 1981, the Furniture and Home Furnishings Group sales were $313.3 million or 13.2% of the consolidated sales, and operating earnings before income taxes, corporate expenses and interest cost were $40.1 million or 15.3% of the operating earnings of INTERCO. This is a return on sales of 12.8%.

There are several significant trends emerging which should have a favorable impact on the furniture and home furnishings industry in the coming years. Due to rapidly rising cost of travel, families are inclined to spend more time at home, which adds emphasis to the home and home life and, consequently, stimulates improvements to make the home more appealing. From past experience, this growing emphasis on the home should prove to be a major benefit to companies in the home furnishings industry, and especially to the INTERCO companies, *Broyhill* and *Ethan Allen*, whose furniture products help homemakers completely refurnish their homes and whose accessories and accent pieces help provide a bright and cheerful atmosphere within the home.


Another significant and highly encouraging factor for the furniture and home furnishing industry is the forecast of demographic trends for the 1980's. A larger part of the population will move into the 25-40 age group; and it has been demonstrated that persons in this age group are the major purchasers of furniture and home furnishings. Their purchases include furnishing of a home for the first time, adding specific pieces of furniture as the size of the family and the home increases, and completely refurnishing all or portions of the home as the family matures.

INTERCO is uniquely positioned to take full advantage of the projected growth in the furniture and home furnishings industry through its acquisition of *Ethan Allen* and *Broyhill*.

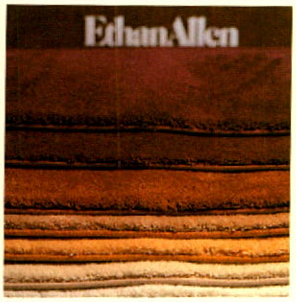
The two companies, producing complete lines of household furniture, differ substantially in their marketing approaches. *Ethan Allen* manufactures furniture to retail in the upper price range, particularly American Traditional, and markets its products principally through 320 Showcase Galleries and accessory stores throughout the United States and in Canada. *Broyhill* produces a broad line of furniture in the medium price range and sells directly to some 10,000 furniture dealers and department stores throughout the United States and many foreign countries. This diversification enables INTERCO to provide a product for almost every consumer in the country. Further, as consumers abroad demand more and more American made furniture, our export programs are geared to meet this demand.

In contrast to *Broyhill* which does not operate retail stores, *Ethan Allen* has established new *Ethan Allen* Classic Galleries. This has been done to recognize the fact that many people will be updating and refurbishing their room decor through the use of new accessories, lamps, pictures, mirrors, area rugs, draperies and wallpaper. In addition, the Classic Galleries feature rugs and porcelains from the Orient, brasses from India, antique-type reproductions from Italy and other European countries, and clocks, pictures and accessories from domestic sources. These retail galleries bring all of the above product categories together on a coordinated basis to give consumers an economical means of redecorating.

Over the years, *Ethan Allen* and *Broyhill* have invested heavily in plant and equipment and, in total, operate 45 factories and 12 major distribution centers and consolidation warehouses. Both companies are continuously seeking out new equipment which would enable them to produce a better product. Today, we operate some of the most modern production facilities and equipment in the industry.

A major factor to be considered in the furniture industry is the cost of transporting the finished product from the manufacturing plant to the customer. In an effort to control these costs, *Ethan Allen* will commence construction on a new West Coast manufacturing facility and distribution center during the 1982 fiscal year. Also recognizing the advantages of producing the finished product in a location closer to prospective customers, *Broyhill* acquired a furniture manufacturing plant in the Southwest within the last year.

INTERCO is optimistic that its newest consumer product group — Furniture and Home Furnishings, will continue the enviable records of *Ethan Allen* and *Broyhill* in the furniture industry.


Ethan Allen

Fiscal 1981 in Review

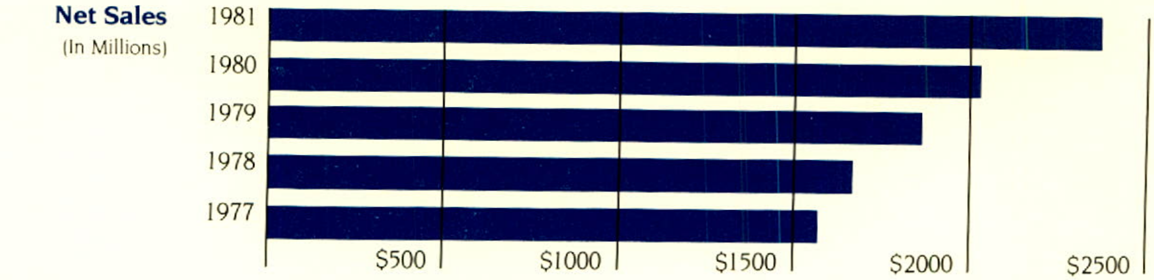
During fiscal 1981 and for the seventeenth consecutive year, INTERCO achieved record sales and earnings, and maintained its strong financial position.

On December 1, 1980, we completed the acquisition of *Broyhill Furniture Industries, Inc.* The sales and earnings of *Broyhill* are included in the consolidated statement of earnings for the three months ended February 1981. The consolidated balance sheet at February 28, 1981, includes *Broyhill*, but because the acquisition was accounted for as a purchase, the consolidated balance sheet at February 29, 1980, has not been restated.

The following represents our four operating groups' sales and earnings for a five-year period, in thousands of dollars. These figures have been restated for the retroactive restatement of capital leases at February 28, 1977.

Years Ended	**1981**	1980	1979	1978	1977
Net sales:					
Apparel	**$ 850,970**	$ 818,380	$ 731,259	$ 640,487	$ 576,019
General Retail	**645,940**	630,309	582,441	521,178	498,557
Footwear	**558,291**	554,955	537,758	504,992	491,856
Furniture	**313,255**	20,663	—	—	—
Total	**$2,368,456**	$2,024,307	$1,851,458	$1,666,657	$1,566,432
Earnings before income taxes:					
Apparel	**$ 109,826**	$ 105,873	$ 95,585	$ 86,745	$ 78,050
General Retail	**27,296**	41,149	40,581	38,096	32,473
Footwear	**83,920**	65,435	61,520	44,552	48,768
Furniture	**40,052**	3,101	—	—	—
	261,094	215,558	197,686	169,393	159,291
Less corporate expenses and interest cost	**(22,977)**	(9,823)	(10,817)	(7,814)	(9,899)
Total	**238,117**	205,735	186,869	161,579	149,392
Income taxes	**113,787**	99,029	94,293	79,745	73,122
Net earnings	**$ 124,330**	$ 106,706	$ 92,576	$ 81,834	$ 76,270
As a percent of sales	**5.2%**	5.3%	5.0%	4.9%	4.9%

Note: For fiscal 1980, the Furniture Group contains the operating results of *Ethan Allen* for the month of February 1980. For fiscal 1981, the Furniture Group includes operating results for a full year for *Ethan Allen* and for three months for *Broyhill*.



Sales

Net sales for the year were a record $2.37 billion, an increase of $344.2 million, or 17.0% over $2.02 billion for the prior year.

The sales contribution by each operating group of the company is compared in millions of dollars as follows:

	Fiscal 1981		Fiscal 1980		%
	Sales	**%**	Sales	%	Change
Apparel	**$ 851.0**	**35.9**	$ 818.4	40.4	4.0
General Retail	**645.9**	**27.3**	630.3	31.2	2.5
Footwear	**558.3**	**23.6**	554.9	27.4	0.6
Furniture	**313.3**	**13.2**	20.7	1.0	—
	$2,368.5	**100.0**	$2,024.3	100.0	17.0

Each of our four operating groups contributed record high sales in fiscal 1981 as well as in fiscal 1980.

Sales for the year were affected by the slowdown in the economy and the effect of retailers controlling their inventory levels.

The net sales of the company, by quarter, in millions of dollars were:

	Fiscal 1981	Fiscal 1980
First quarter	**$ 532.4**	$ 463.8
Second quarter	**599.1**	532.1
Third quarter	**607.0**	519.2
Fourth quarter	**630.0**	509.2
	$2,368.5	$2,024.3

Earnings

Earnings before income taxes were $238.1 million, an increase of $32.4 million, or 15.7% from $205.7 million last year.

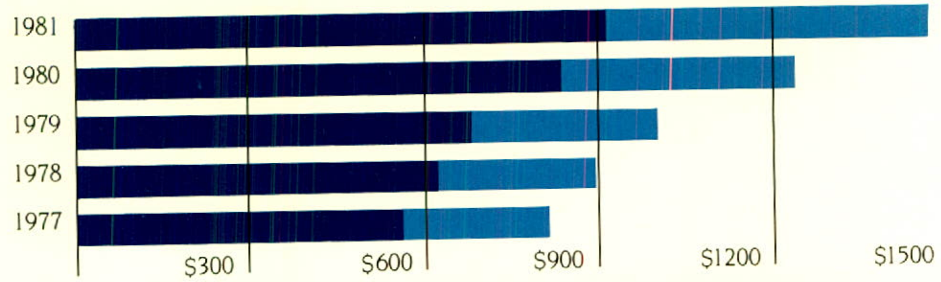
Operating earnings by each operating group are compared, in millions of dollars, as follows:

	Fiscal 1981		Fiscal 1980		%
	Amount	**%**	Amount	%	Change
Apparel	**$109.8**	**42.1**	$105.9	49.1	3.7
General Retail	**27.3**	**10.5**	41.2	19.1	(33.7)
Footwear	**83.9**	**32.1**	65.4	30.4	28.2
Furniture	**40.1**	**15.3**	3.1	1.4	—
	$261.1	**100.0**	$215.6	100.0	21.1

Our margin of profitability, operating earnings to sales, was 12.9% for the Apparel Group, 4.2% for the General Retail Group, 15.0% for the Footwear Group, and 12.8% for the Furniture Group. Margins in the General Retail Group were affected by above normal mark-downs and heavy promotions during the year.

Net earnings for the year were a record $124.3 million, an increase of $17.6 million or 16.5% over the net earnings of $106.7 million for the previous year.

Total Assets
Total Stockholders' Equity
(In Millions)



Book Value Per Common Share

Fully diluted earnings per share were $7.61, an increase of 3.5% over the $7.35 in fiscal 1980. The percentage increase in earnings per share was less than the percentage increase in net earnings due to the increase of the average common stock equivalents of the preferred stock in computing earnings per share for the current year.

Net earnings and earnings per common share for each quarter are compared in the following:

	Net Earnings (In Millions)		Earnings Per Share	
	Fiscal 1981	Fiscal 1980	**Fiscal 1981**	Fiscal 1980
First quarter	**$ 23.0**	$ 19.8	**$1.41**	$1.37
Second quarter	**29.8**	25.3	**1.82**	1.76
Third quarter	**33.0**	28.3	**2.02**	1.98
Fourth quarter	**38.5**	33.3	**2.36**	2.24
	$124.3	$106.7	**$7.61**	$7.35

Financial Position

The company's strong financial position continued during the 1981 fiscal year.

- Working capital, the excess of current assets over current liabilities, was $714.7 million at the end of fiscal 1981. The current ratio was 3.7 to 1 at February 28, 1981.
- Accounts receivable were $308.1 million at February 28, 1981. On a comparative basis, excluding *Broyhill's* accounts receivable acquired in the acquisition, the increase was 13.1%.
- Inventories increased by 19.7% to $633.5 million at February 28, 1981. On a comparative basis, excluding *Broyhill's* inventories acquired in the merger, the increase was 8.2%, reflecting the effect of our inventory control programs.
- Total assets increased $230.1 million and aggregated $1.47 billion at February 28, 1981 as compared to $1.24 billion at February 29, 1980.
- Long-term debt, including capitalized leases of $79.9 million, less current maturities, was $267.1 million at year end, which is 29.2% of the stockholders' equity of the company.
- Stockholders' equity was $914.0 million at February 28, 1981, an increase of 9.3% from $836.3 million at the end of fiscal 1980. The return on average stockholders' investment was 14.3% for fiscal 1981. Book value per common share increased to $57.98 from $52.21 one year ago.

Capital Expenditures

Capital expenditures of $68.7 million, which included $5.9 million of capital leases, were made during fiscal 1981 for new retail outlets, new manufacturing plants and distribution centers, the refurbishment of a number of retail locations, the modernization of manufacturing plants and equipment, and the expansion of existing distribution facilities. Depreciation expense for the year was $32.8 million.

For fiscal 1982, capital expenditures for company-owned property are forecast to be $59 million and will include approximately 75 general retail, furniture and footwear stores and departments, as well as expansion of manufacturing plants and customer distribution centers. Depreciation for fiscal 1982 will be approximately $40 million.

Dividends

Fiscal 1981 was the 16th consecutive year of increased common stock dividends and the 70th consecutive year of cash dividend payments. Cash dividends of $44.6 million were paid during the fiscal year, with $37.0 million to holders of common stock and the remainder to holders of preferred stock.

Quarterly common stock cash dividends per share were paid as follows:

	Fiscal 1981	Fiscal 1980
First quarter	**$0.66**	$0.55
Second quarter	**0.66**	0.60
Third quarter	**0.66**	0.60
Fourth quarter	**0.66**	0.60
	$2.64	$2.35

The quarterly dividend rate on common stock was increased to $0.72 per common share, an annual indicated rate of $2.88 per common share, effective with the April 15, 1981 payment.

The annual dividend rate on the Series D preferred stock is $7.75 per share.

Capital Stock

On February 28, 1981, there were 14,013,583 shares of common stock and 1,014,399 shares of preferred stock outstanding.

During fiscal 1981, the company completed the repurchase of 500,000 shares of common stock, and on April 14, 1980, the Board authorized the repurchase of an additional 500,000 common shares. Through February 28, 1981, we had purchased 571,665 shares on the open market or by private transaction at a cost of $22.2 million.

The common and preferred shares of INTERCO are traded on the New York Stock Exchange. Fluctuation in the high and low quoted prices, for each quarter, are shown in the following:

	Fiscal 1981				Fiscal 1980			
	Common		**Preferred**		Common		Preferred	
	High	**Low**	**High**	**Low**	High	Low	High	Low
First quarter	**$42**	**$36⅛**	**$ 90**	**$ 81**	$39¼	$36	$—	$—
Second quarter	**51½**	**40**	**111**	**88**	42¾	37¾	—	—
Third quarter	**53⅝**	**46½**	**116**	**107**	42¾	37	—	—
Fourth quarter	**49¾**	**44¼**	**108**	**95**	40⅛	36½	92	88½

Note: The preferred stock commenced trading in January 1980.

The closing market price of INTERCO's common and preferred stock at fiscal year end 1981 was $49⅜ and $107⅜ per share, respectively.

Acquisition

On December 1, 1980, the company acquired all the outstanding stock of *Broyhill Furniture Industries, Inc.* for $151.6 million. Its operations have been included in INTERCO's reporting in fiscal 1981, from the date of acquisition.

For a description of *Broyhill's* business, refer to page 4 of this report. Additional information concerning the purchase price and results of operations are included in Note 2 of the Notes to Consolidated Financial Statements.

Operating Board

The following were appointed to the Operating Board of the Company during the year:

- Paul H. Broyhill, Chairman of the Board of *Broyhill Furniture Industries, Inc.*
- Webster L. Cowden, Jr., President of *Cowden Manufacturing Company.*
- Herschel Cravitz, President of *Queen Casuals, Inc.*
- Harry M. Krogh, President of *The Florsheim Shoe Company.*
- Irving S. Wahl, Chairman of the Board of *Stuffed Shirt/Stuffed Jeans, Inc.*

Trademarks and Tradenames

The trademarks and tradenames of INTERCO and its subsidiaries, appearing in this Annual Report, are italicized. The prominent trademarks and tradenames appear on the cover.

Charts

The charts, in the Fiscal 1981 in Review, have been restated for the retroactive restatement of capital leases at February 28, 1977.

Form 10-K — Annual Report

A copy of INTERCO INCORPORATED's current Form 10-K Report filed with the Securities and Exchange Commission can be obtained by writing to: Treasurer, INTERCO INCORPORATED, Ten Broadway, St. Louis, Missouri 63102.

Contents

INTERCO Consolidated Financial Statements

Consolidated Balance Sheet

(Dollars in thousands)

Assets	February 28, 1981	February 29, 1980
Current assets:		
Cash	**$ 6,326**	$ 6,561
Marketable securities	**11,827**	53,011
Receivables, less allowances of $14,455 ($13,836 in 1980)	**308,051**	243,743
Inventories	**633,514**	529,058
Prepaid expenses and other current assets	**20,898**	20,817
Total current assets	**980,616**	853,190
Marketable investment securities	**14,298**	37,707
Property, plant and equipment:		
Land	**26,238**	19,192
Buildings and improvements	**347,250**	280,246
Machinery and equipment	**227,541**	175,424
	601,029	474,862
Less accumulated depreciation	**188,922**	165,226
Net property, plant and equipment	**412,107**	309,636
Other assets	**62,116**	38,503
	$1,469,137	$1,239,036

See accompanying notes to consolidated financial statements.

Liabilities and Stockholders' Equity	February 28, 1981	February 29, 1980
Current liabilities:		
Current maturities of long-term debt	$ 12,958	$ 6,335
Current maturities of capital lease obligations	5,845	5,501
Accounts payable	161,692	143,629
Accrued employee compensation	27,992	19,437
Other accrued expenses	32,243	31,713
Income taxes	25,208	39,742
Total current liabilities	265,938	246,357
Long-term debt, less current maturities	187,208	60,225
Obligations under capital leases, less current maturities	79,925	80,718
Other long-term liabilities	22,066	15,423
Stockholders' equity:		
Preferred stock, no par value, authorized 10,000,000 shares — issued, 1,014,399 shares in 1981 and 972,376 shares in 1980	101,440	97,238
Common stock, $7.50 stated value, authorized 50,000,000 shares — issued, 14,585,248 shares in 1981 and 14,550,745 shares in 1980	109,389	109,131
Capital surplus	47,961	47,441
Retained earnings	677,367	597,764
	936,157	851,574
Less 571,665 (394,726 in 1980) shares of common stock in treasury, at cost	22,157	15,261
Total stockholders' equity	914,000	836,313
	$1,469,137	$1,239,036

Consolidated Statement of Earnings

(Dollars in thousands except per share data)

Years Ended	**February 28, 1981**	February 29, 1980	February 28, 1979
Income:			
Net sales	**$2,368,456**	$2,024,307	$1,851,458
Other income, net	**27,419**	23,960	19,503
	2,395,875	2,048,267	1,870,961
Costs and expenses:			
Cost of sales	**1,591,359**	1,379,768	1,266,618
Selling, general and administrative expenses	**546,115**	453,448	407,904
Interest expense	**20,284**	9,316	9,570
	2,157,758	1,842,532	1,684,092
Earnings before income taxes	**238,117**	205,735	186,869
Income taxes	**113,787**	99,029	94,293
Net earnings	**$ 124,330**	$ 106,706	$ 92,576
Earnings per share	**$7.61**	$7.35	$6.37

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

(Dollars in thousands)

Years Ended	**February 28, 1981**	February 29, 1980	February 28, 1979
Working capital provided by:			
Net earnings	**$124,330**	$106,706	$ 92,576
Items not affecting working capital:			
Depreciation	**32,845**	24,390	21,850
Other, net	**2,406**	1,973	1,014
Operations	**159,581**	133,069	115,440
Disposal of property, plant and equipment	**3,038**	4,873	3,677
Issuance of preferred stock	**3,666**	88,762	—
Issuance of common stock	**1,473**	298	6,288
Additions to long-term debt	**136,992**	320	2,970
Additions to capital lease obligations	**5,509**	4,759	16,427
Reduction of marketable investment securities	**28,416**	7,846	4,153
Other, net	**—**	1,751	181
	338,675	241,678	149,136
Working capital used for:			
Cash dividends	**44,553**	33,563	30,425
Additions to property, plant and equipment:			
Company owned property	**62,857**	41,849	30,173
Leased property	**5,860**	4,759	16,427
Reduction of long-term debt	**16,571**	9,227	4,625
Reduction of capital lease obligations	**6,302**	5,402	7,379
Purchase of common treasury shares	**6,896**	9,474	5,787
Conversion of preferred stock	**159**	—	—
Marketable investment securities	**3,993**	7,677	39,938
Additional payment — purchased companies	**—**	—	2,887
Other, net	**1,316**	—	—
	148,507	111,951	137,641
Acquisitions (less working capital of $69,276 in 1981, $90,664 in 1980 and $18,025 in 1979):			
Properties	**69,637**	84,650	5,977
Long-term debt and capital lease obligations	**(6,562)**	(41,112)	(839)
Excess of cost over fair value of net assets acquired	**19,314**	13,098	(966)
Other, net non-current assets	**(66)**	4,136	1,806
Net non-current assets	**82,323**	60,772	5,978
	230,830	172,723	143,619
Increase in working capital	**$107,845**	$ 68,955	$ 5,517
Working capital increased (decreased) by:			
Cash and marketable securities	**$(41,419)**	$ (8,590)	$(45,632)
Receivables	**64,308**	27,197	21,452
Inventories	**104,456**	89,099	60,136
Prepaid expenses and other current assets	**81**	10,937	1,296
Foreign bank borrowings	**—**	—	7,998
Current maturities of long-term debt	**(6,623)**	(2,311)	(38)
Current maturities of capital lease obligations	**(344)**	(1,899)	(525)
Accounts payable and accrued expenses	**(27,148)**	(37,535)	(31,859)
Income taxes	**14,534**	(7,943)	(7,311)
	$107,845	$ 68,955	$ 5,517

See accompanying notes to consolidated financial statements.

Consolidated Statement of Stockholders' Equity

(Dollars in thousands except per share data)

	Preferred Stock	Common Stock Issued	Common Stock In Treasury	Capital Surplus	Retained Earnings	Total
Balance February 28, 1978	$ —	$107,559	$ —	$50,903	$463,050	$621,512
Net earnings					92,576	92,576
Cash dividends:						
Common stock — $2.10 per share					(30,425)	(30,425)
Issuance of 166,635 common shares for acquisition		1,250		4,304		5,554
Exercise of stock options:						
Common — 30,790 shares		231		496		727
Restricted stock plan:						
Common — 199 shares		1		6		7
Purchase of 152,300 common treasury shares			(5,787)			(5,787)
Balance February 28, 1979	—	109,041	(5,787)	55,709	525,201	684,164
Net earnings					106,706	106,706
Cash dividends:						
Common stock — $2.35 per share					(33,563)	(33,563)
Issuance of 934,249 preferred shares for acquisition	93,425			(8,097)		85,328
Issuance of 38,127 preferred shares for conversion of debentures	3,813			(379)		3,434
Exercise of stock options:						
Common — 10,294 shares		77		159		236
Restricted stock plan:						
Common — 1,672 shares		13		49		62
Purchase of 242,426 common treasury shares			(9,474)			(9,474)
Investment valuation allowance					(580)	(580)
Balance February 29, 1980	97,238	109,131	(15,261)	47,441	597,764	836,313
Net earnings					124,330	124,330
Cash dividends:						
Preferred stock					(7,511)	(7,511)
Common stock — $2.64 per share					(37,042)	(37,042)
Issuance of 39,964 preferred shares for conversion of debentures	3,996			(432)		3,564
Issuance of 50 additional preferred shares for acquisition	5			(1)		4
Conversion of preferred stock:						
Series D — 1,591 shares	(159)	26		133		—
Exercise of stock options:						
Preferred — 3,600 shares	360			(262)		98
Common — 29,780 shares		223		1,044		1,267
Restricted stock plan:						
Common — 1,284 shares		9		38		47
Purchase of 176,939 common treasury shares			(6,896)			(6,896)
Investment valuation allowance					(174)	(174)
Balance February 28, 1981	$101,440	$109,389	$(22,157)	$47,961	$677,367	$914,000

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

1. Significant Accounting Policies

The company and its subsidiaries employ generally accepted accounting principles on a consistent basis to present fairly their consolidated financial position, results of operations, and changes in financial position. The major accounting policies of the company are set forth below.

Principles of Consolidation — The consolidated financial statements include the accounts of the company and all domestic and foreign subsidiaries, the majority of which are wholly owned. All material intercompany transactions have been eliminated in consolidation.

Fiscal Year — The company's fiscal year ends on the last day of February. In this report, reference to fiscal 1981 refers to the fiscal year ended February 28, 1981, fiscal 1980 refers to the fiscal year ended February 29, 1980, and fiscal 1979 refers to the fiscal year ended February 28, 1979.

Marketable Securities — Marketable securities, consisting principally of commercial paper, are stated at cost which approximates market.

Inventories — Inventories are stated at the lower of cost (first-in, first-out) or market, except for most footwear manufacturing inventories which are valued on the "last-in, first-out" method of inventory valuation.

Marketable Investment Securities — Marketable investment securities consist of bonds and preferred stocks held for long-term investment. Dividend and interest income are accrued as earned. The cost of marketable investment securities sold is determined on the specific identification method.

Marketable equity securities (preferred stocks) are carried at the lower of cost or market. A valuation allowance, representing the excess of cost over market of these equity securities, is included in stockholders' equity. Other marketable investment securities (bonds) are carried at cost as there is no indication of a permanent impairment in value in any portion of the portfolio and there is no intention to liquidate the securities portfolio at less than cost.

Property, Plant and Equipment — Property, plant and equipment is stated at cost. Facilities and equipment leased under capital leases are included in property, plant and equipment with the corresponding principal payments carried in obligations under capital leases. Expenditures for improvements are capitalized, while normal repairs and maintenance are expensed as incurred. Interest expense is capitalized on major construction projects. When properties are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts and gains or losses on the dispositions are reflected in operations.

Depreciation — For financial reporting purposes, the company employs both accelerated and straight-line methods of computing depreciation. Amortization of assets recorded under capital leases is included in depreciation expense. Depreciation expense is computed based on the estimated useful lives of the respective assets which generally range from 15 to 45 years for buildings and improvements, and from 3 to 20 years for machinery and equipment. Approximately 87%, 86% and 85% of depreciation expense was computed on the straight-line method in fiscal 1981, 1980 and 1979, respectively.

Excess of Cost Over Fair Value of Net Assets Acquired — The excess of cost over fair value of net assets of companies acquired is being amortized on a straight-line basis, generally over 40 years.

Start-Up Expenses — Start-up expenses of new facilities are charged to operations in the fiscal year incurred.

Pension Plans — The company's policy with respect to pension plans is to fund pension costs accrued, and to amortize prior service costs, generally over 30 years.

Income Taxes — Investment tax credits are reflected as a reduction of Federal income taxes in the period in which qualified property is placed in service. It is the company's intent that the undistributed earnings of subsidiaries will either be reinvested in the subsidiaries or distributed tax-free to the parent company. Accordingly, no provision has been made for income taxes on such undistributed earnings.

Notes to Consolidated Financial Statements

(continued)

2. Business Combinations

On December 1, 1980, the company acquired all the outstanding stock of Broyhill Furniture Industries, Inc., a manufacturer of household furniture and other furniture related products. The acquisition price of $151,599, including capitalized expenses, was paid by the issuance of five-year, 10% notes, totaling $43,581 with equal annual payments, the issuance of a short-term, 10% note which matured on January 12, 1981 totaling $59,728, and the remainder in cash. For investment valuation, the notes were recorded at par value as the interest rate reflected the fair market value on the date of acquisition. The transaction has been accounted for as a purchase; and, accordingly, Broyhill's operations have been included in the consolidated statements from the date of acquisition. The total acquisition cost exceeded the fair value of the net assets acquired by $19,314, and the excess has been allocated to trademarks and goodwill.

On January 28, 1980, the company acquired, under the purchase method of accounting, all the outstanding stock of Ethan Allen, Inc., a manufacturer and retailer of household furniture and related home furnishings. The acquisition price of $151,436, including capitalized expenses, was paid by the issuance of 934,299 shares of INTERCO INCORPORATED Series D preferred stock with an assumed fair market value of $91.50 per share, and the remainder in cash.

The following unaudited summary, prepared on a pro forma basis, combines the consolidated results of operations of the company for fiscal years 1981 and 1980 with those of Broyhill Furniture Industries, Inc. for its forty-one weeks ended November 29, 1980 and its fiscal year ended November 24, 1979, and Ethan Allen, Inc. for its fiscal year ended September 29, 1979.

	1981	1980
Net sales	**$2,564,351**	$2,495,543
Net earnings	**$ 126,689**	$ 128,246
Earnings per share	**$7.75**	$7.74

The pro forma data have been adjusted, net of income tax effects, to reflect interest expense, the depreciation and amortization of the fair value of the acquired assets, and the excess of cost over fair value of the net assets acquired.

In fiscal 1979, the company acquired all the outstanding stock of International Hat Company in exchange for 166,635 shares of common stock. Based upon the profit performance of the acquired company, 55,556 additional shares had been earned at February 28, 1981 and will be issued on April 15, 1981. Also in fiscal 1979, the company acquired substantially all of the net assets of Alberts, Inc. for $18,347 in cash. Both transactions were accounted for as purchases and the results of operations were included from the respective dates of acquisition.

3. Inventories

Inventories are summarized as follows:

	1981	1980
Retail merchandise	**$273,853**	$262,376
Finished products	**169,694**	124,182
Work in process	**59,443**	43,342
Raw materials	**130,524**	99,158
	$633,514	$529,058

All the major categories of inventory, except retail merchandise, include certain items priced on the "last-in, first-out" method. Had the "first-in, first-out" method been applied to all inventories, they would have been stated at approximately $664,927 and $562,348 at February 28, 1981 and February 29, 1980, respectively.

4. Marketable Investment Securities

Marketable investment securities consist of the following:

	1981	1980
Marketable equity securities, at cost	**$ 3,586**	$ 3,506
Less valuation allowance	**754**	580
Marketable equity securities, at market	**2,832**	2,926
Bonds, at cost	**11,466**	34,781
	$14,298	$37,707

The portfolio of marketable equity securities includes gross unrealized losses of $754 at February 28, 1981. Net realized losses on the sale of securities, after applicable taxes, included in the determination of net earnings amounted to $393 and $90 for fiscal 1981 and 1980, respectively. There were no realized gains or losses during fiscal 1979.

5. Lines of Credit

Average short-term borrowings outstanding during fiscal 1981 and fiscal 1980 were $37,900 and $4,900 with a weighted average interest rate thereon of 15.6% and 16.1%, respectively. Maximum short-term borrowings at any month end were $80,300 in fiscal 1981 and $23,400 in fiscal 1980.

The company amended its credit agreement effective April 1, 1981 enabling it to borrow up to $100,000 in domestic or Euro-Dollar loans through February 28, 1983. Borrowings outstanding as of February 28, 1983 are repayable from that date through February 29, 1988. Domestic interest rates will approximate bank prime while rates for Euro-Dollar borrowings will approximate the London Inter-Bank Offering Rate plus 0.5%. The amended agreement requires the company to pay a maximum commitment fee of 0.5% per annum. There were no borrowings outstanding under the agreement at February 28, 1981.

The company also maintains other bank lines of credit which provide credit availability and support the sale of commercial paper. On February 28, 1981, the total unused lines of credit were $90,000.

6. Long-Term Debt

Long-term debt consists of the following:

	1981	1980
Commercial paper	**$ 80,298**	$ —
10% promissory installment notes, payable $8,716 annually, 1981 through 1985	**43,581**	—
4⅝% promissory installment notes, payable $1,875 annually, 1981-1989, and balance in 1990	**29,375**	31,250
8⅝% promissory installment note, payable $1,000 annually, 1981-1993, and balance in 1994	**18,000**	19,000
7¾% to 11½% industrial revenue bonds	**12,745**	—
5¼% convertible subordinated debentures due August 1, 1996	**79**	360
4⅞% convertible subordinated debentures due January 1, 1998	**946**	4,691
Other debt at 1% to 12% interest rates, payable in varying amounts through 2006	**18,708**	15,366
	203,732	70,667
Less current maturities	**12,958**	6,335
Less present value adjustment	**3,566**	4,107
	$187,208	$60,225

On March 3, 1981, the company sold $100,000 of 14¼% promissory notes with delayed delivery of $14,250 in June 1981 and $15,000 in July 1981. The notes mature on February 15, 1991 and are subject to call on February 15, 1988, without penalty. Commission on the sale, amounting to $700, along with other expenses paid in connection with the issuance, will be charged to operations as interest expense over the life of the notes. At February 28, 1981, the company's outstanding commercial paper amounted to $80,298. The proceeds of the $100,000 notes received on March 3, 1981, were used to reduce commercial paper in the amount of $70,050 and it is the company's intent to redeem

the balance with the proceeds received from the delayed delivery; therefore, the outstanding commercial paper balance at February 28, 1981 is being accounted for as long-term debt.

In the merger with Broyhill Furniture Industries, Inc. on December 1, 1980, as part of the purchase price, the company issued 10% promissory installment notes for $43,581 with equal annual payments, due October 1, 1985. Also in the merger, the company assumed the long-term debt of Broyhill Furniture Industries, Inc. consisting of $486 due within one year and $6,562 due thereafter through 1994. The notes issued in the merger and the notes assumed reflect interest rates representing fair market value at the date of acquisition.

The present value adjustment reflected in the table relates to the long-term debt assumed in the acquisition of Ethan Allen, Inc.

The industrial revenue bonds, which mature on varying dates from 1983 through 2001, were issued in fiscal 1981 by development authorities for the construction of distribution and office facilities.

Maturities of long-term debt are $12,958, $13,522, $17,917, $14,368 and $13,375 for fiscal years 1982 through 1986, respectively.

The 5¼% and 4⅞% convertible subordinated debentures are convertible into the company's Series D preferred stock prior to maturity at $62.00 and $105.50 per share, respectively, subject to anti-dilution provisions. They are subordinated as to principal and interest to all senior indebtedness, are redeemable at the company's option prior to maturity at prices ranging from 103.125% to 100% of the principal amount, and are subject to annual sinking fund payments beginning in 1982 and 1984, respectively.

The various loan agreements contain restrictions relating to the financial condition of the company. The most restrictive of these convenants require that the working capital ratio be at least 2.0 to 1, tangible net worth be at least $600,000, retained earnings be at least $43,810, funded indebtedness not exceed 60% of tangible net worth or exceed 50% of net tangible assets, debt secured by liens not exceed 15% of tangible net worth, and domestic subsidiary borrowing not exceed $50,000.

7. Obligations Under Capital Leases

The amount capitalized under capital leases is the present value of the minimum lease payments or the fair value of the leased properties at the beginning of the respective lease terms. Generally, interest rates applicable to capital leases range between 4¾% and 16¾% for leased facilities and between 7¾% and 26¼% for leased equipment. Obligations under capital leases amounted to $85,770 and $86,219 at February 28, 1981 and February 29, 1980, respectively. Maturities of these obligations are $5,845, $5,728, $5,388, $4,889 and $4,999 for fiscal years 1982 through 1986, respectively.

8. Capitalized Interest

During fiscal 1981, pursuant to a recently issued pronouncement of the Financial Accounting Standards Board (FASB), the company capitalized $832 of interest expense that was incurred with respect to certain assets during the period of time required to get them ready for their intended use. As a result, interest expense, as reported in the financial statements, has been reduced and property, plant and equipment has been increased by the amount of interest capitalized.

9. Preferred Stock

The company's preferred stock is issuable in series. At February 28, 1981 and February 29, 1980, the outstanding preferred stock consisted of 1,014,399 and 972,376 shares, respectively, of Series D $7.75 cumulative convertible with stated and involuntary liquidating value of $100.00 per share.

Each share of the Series D preferred stock is convertible into 2.1621 shares of the company's common stock. The Series D preferred stock may be redeemed on and after January 29, 1989, at $104.75 per share, decreasing to $100.00 per share in 1994. Subject to the satisfaction of certain conditions relating to the amounts of dividends paid on the company's common stock, the Series D preferred stock may be redeemed on and after January 29, 1986 at $107.75 per share, decreasing to $100.00 per share in 1994.

At February 28, 1981, 10,240 shares of Series D preferred stock were reserved for the conversion of the 5¼% and 4⅞% convertible, subordinated debentures.

10. Common Stock

Shares of common stock were reserved for the following purposes at February 28, 1981:

	Number of Shares
Common stock options:	
Granted	**394,334**
Available for grant	**310,793**
Restricted stock plan of pooled company	**1,870**
Contingent shares based on profit performance	**55,556**
Conversion of preferred stock	**2,215,371**
	2,977,924

All options granted under the company's 1967 Stock Option Plan are qualified options and expire on May 20, 1981. No additional options may be granted under this plan.

On June 23, 1980, the stockholders approved the INTERCO INCORPORATED 1980 Stock Option Plan authorizing the granting of non-qualified options and stock appreciation rights to key employees, including officers, at 100% of fair market value on the date of grant. At February 28, 1981, options for 25,450 shares were outstanding. These options were granted between December 19, 1980 and January 27, 1981, at prices ranging from $44.875 to $48.25 per share, and expire ten years from date of grant.

Also on June 23, 1980, the stockholders approved amendments of the 1972 and 1977 Stock Option Plans to allow for the granting of stock appreciation rights. At February 28, 1981, options for 95,096 and 235,533 shares were outstanding under the 1972 and 1977 Plans, respectively. Options under the 1972 Plan were granted between September 5, 1974 and March 12, 1979, at prices ranging between $20.50 and $40.50 per share, and except for 1,644 qualified option shares, expire ten years after date of grant. Options under the 1977 Plan were granted between November 17, 1978 and December 2, 1980, at prices ranging between $35.00 and $45.4375 per share, and expire ten years from date of grant.

Under the company's stock option plans, certain key employees may be granted non-qualified options, stock appreciation rights, or a combination of non-qualified options and stock appreciation rights. Options and stock appreciation rights granted under the 1972 and 1977 plans may not be less than 85% of the fair market value of the common stock on the date of grant. All options which have been granted, qualified and non-qualified, were at 100% of fair market value on the date of grant. Qualified options expire five years after the date of grant or on May 20, 1981, whichever first occurs, and non-qualified options expire ten years after the date of grant. At February 28, 1981, no stock appreciation rights had been granted.

Changes in options granted are summarized as follows:

	1981		1980		1979	
	Shares	**Average Price**	Shares	Average Price	Shares	Average Price
Beginning of year	**371,821**	**$34.29**	394,283	$33.94	144,439	$28.90
Granted	**63,750**	**42.28**	6,050	40.61	287,574	35.09
Exercised	**(29,780)**	**34.66**	(10,294)	21.92	(30,790)	20.98
Cancelled	**(11,457)**	**36.46**	(18,218)	35.73	(6,940)	34.42
End of year	**394,334**	**35.49**	371,821	34.29	394,283	33.94
Exercisable at end of year	**142,882**		75,869		61,992	

Notes to Consolidated Financial Statements

(Continued)

11. Income Taxes

Income tax expense is composed of the following:

	1981	1980	1979
Current:			
Federal	**$ 96,699**	$ 87,621	$82,823
State and local	**12,196**	11,341	9,087
Foreign	**1,475**	2,815	2,757
	110,370	101,777	94,667
Deferred	**3,417**	(2,748)	(374)
	$113,787	$ 99,029	$94,293
Investment and jobs tax credits	**$ 3,023**	$ 2,025	$ 1,266

The following table reconciles the differences between the Federal corporate statutory rate and the company's effective income tax rate:

	1981	1980	1979
Federal corporate statutory rate	**46.0%**	46.0%	47.7%
State and local income taxes, net of Federal tax benefit	**2.8**	2.9	2.6
Investment tax credits	**(1.2)**	(1.0)	(.7)
Foreign taxes, including foreign currency translation effects	**.2**	.2	.4
Other	**—**	—	.5
Effective income tax rate	**47.8%**	48.1%	50.5%

Certain items are recognized for income tax purposes in years other than those in which they are reported in the consolidated financial statements. Future Federal income tax benefits at February 28, 1981 and February 29, 1980 are included in the accompanying consolidated balance sheet, as follows:

	1981	1980
Prepaid expenses and other current assets	**$7,005**	$9,296
Other long-term liabilities	**(4,183)**	(838)
	$2,822	$8,458

The Federal income tax returns of the company and its major subsidiaries have been examined through fiscal year ended February 28, 1978.

12. Pension Plans

The company and its subsidiaries have several pension plans covering substantially all employees, including certain employees in foreign countries. Total pension expense was $17,000, $15,100 and $14,300 in fiscal 1981, 1980 and 1979, respectively. The company makes annual contributions to the plans equal to the amounts accrued for pension expense. Accumulated plan benefits and plan net assets for the company's defined benefit plans as of the most recent valuation dates are presented below.

	1981
Actuarial present value of accumulated plan benefits:	
Vested	**$128,305**
Nonvested	**16,162**
	$144,467
Net assets available for benefits	**$ 86,756**

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 6.3%.

13. Lease Commitments

Substantially all of the company's retail outlets and certain other real properties and equipment are operated under lease agreements expiring at various dates through the year 2003. Leases covering retail outlets and equipment generally require, in addition to stated minimums, contingent rentals based on retail sales and equipment usage. Generally, the leases provide for renewal for various periods at stipulated rates.

Assets recorded under capital leases are as follows:

	1981	1980
Land	**$ 1,068**	$ 1,070
Buildings	**88,092**	85,809
Machinery and equipment	**12,892**	11,392
	102,052	98,271
Accumulated depreciation	**28,535**	23,470
	$ 73,517	$74,801

Future minimum lease payments under capital leases, reduced by minimum rentals from subleases of $2,622, at February 28, 1981 aggregate $164,102, of which $85,770 is included in obligations under capital leases and current maturities, $63,473 represents interest and the balance represents other costs of the leases including taxes, insurance and maintenance. Annual payments under capital leases are $14,471, $13,667, $12,697, $11,738 and $11,411 for fiscal years 1982 through 1986, respectively.

Total rent expense was as follows:

	1981	1980	1979
Basic rentals under operating leases	**$36,537**	$31,144	$27,964
Contingent rentals, operating and capital leases	**25,178**	22,042	20,701
	61,715	53,186	48,665
Less sublease rentals	**1,524**	1,377	1,273
	$60,191	$51,809	$47,392

Included in rent expense above is the cost of services provided by lessors of leased retail departments, estimated to aggregate $10,400, $8,800 and $8,000 in fiscal years 1981, 1980 and 1979, respectively.

Future minimum lease payments under operating leases, reduced by minimum rentals from subleases of $3,160, at February 28, 1981 aggregate $243,154. Annual payments under operating leases are $33,377, $30,832, $27,878, $24,924 and $22,308 for fiscal years 1982 through 1986, respectively.

The company has also guaranteed leases of certain retail outlets of customers which, at February 28, 1981, aggregated approximately $3,800 based on minimum rentals.

14. Litigation

The company is a defendant and may become a defendant in a number of pending or threatened legal proceedings in the ordinary course of business. In the opinion of management, the ultimate liability, if any, of the company from all such proceedings will not have a material adverse effect upon the consolidated financial position or results of operations.

15. Earnings Per Share of Common Stock

Fully diluted earnings per share are based on the weighted average number of shares of common stock and common stock equivalents outstanding during the year, plus those common shares which would have been issued if conversion of all preferred stock and all the debentures had taken place at the beginning of each year or since date of issuance. Stock options, the exercise of which would result in dilution of earnings per share, are considered common stock equivalents. Net earnings for these computations are increased by the net interest expense on the convertible debentures.

Primary earnings per share are based on those shares included in the fully diluted earnings per share calculations; except for fiscal 1979 and prior fiscal years, the conversion of preferred stock had not been assumed, and for this computation, net earnings are reduced by preferred stock dividend requirements. In fiscal 1981 and 1980, the conversion of the preferred stock has been assumed in accordance with the Accounting Principles Board's Opinion No. 15, and the common stock equivalents have been included in the average shares and per share computations since date of issuance. The conversion of the preferred shares reserved for future issuance has not been assumed.

16. Business Segment Information

The company's four business segments are Apparel Manufacturing, General Retail Merchandising, Footwear Manufacturing and Retailing, and Furniture and Home Furnishings. Specific information relating to the operating companies and their products, which comprise each segment, is included on the inside front cover and on pages 4 through 23 of the Annual Report.

Summarized financial information by business segment is as follows:

	1981	1980	1979
Sales to unaffiliated customers:			
Apparel	**$ 850,970**	$ 818,380	$ 731,259
Retail	**645,940**	630,309	582,441
Footwear	**558,291**	554,955	537,758
Furniture	**313,255**	20,663	—
Total	**$2,368,456**	$2,024,307	$1,851,458
Operating earnings:			
Apparel	**$ 109,826**	$ 105,873	$ 95,585
Retail	**27,296**	41,149	40,581
Footwear	**83,920**	65,435	61,520
Furniture	**40,052**	3,101	—
	261,094	215,558	197,686
Corporate expenses and interest cost	**(22,977)**	(9,823)	(10,817)
Earnings before income taxes	**$ 238,117**	$ 205,735	$ 186,869
Identifiable assets at year end:			
Apparel	**$ 441,233**	$ 368,437	$ 357,003
Retail	**329,987**	311,159	286,528
Footwear	**289,791**	272,415	268,187
Furniture	**401,374**	204,707	—
	1,462,385	1,156,718	911,718
Corporate assets	**6,752**	82,318	91,357
Total	**$1,469,137**	$1,239,036	$1,003,075
Depreciation expense:			
Apparel	**$ 7,953**	$ 6,942	$ 6,494
Retail	**10,780**	9,675	8,467
Footwear	**6,798**	6,735	6,325
Furniture	**6,526**	365	—
Capital expenditures:			
Apparel	**$ 23,448**	$ 12,266	$ 11,198
Retail	**24,825**	19,364	27,146
Footwear	**9,604**	9,876	7,442
Furniture	**9,932**	1,517	—

Sales between business segments, which account for less than 1% of the sales of any one business segment, are considered immaterial and are netted against the sales of the respective segment. Operating earnings of the business segment is its sales less all operating expenses. Minority interests in certain subsidiaries are immaterial and have been included in corporate expenses and interest cost.

Identifiable assets are those assets used by each segment in its operations. Corporate assets consist primarily of cash, marketable securities and marketable investment securities.

Substantially all of the company's sales are made to unaffiliated customers and no one customer accounted for 10% of consolidated sales. Foreign operations are not material in relation to the consolidated financial position or results of operations.

17. Inflation Accounting (Unaudited)

Rapidly changing prices have had an increased impact on the company in recent years. Inflation affects the company in many ways — particularly the costs of acquiring inventory and the costs of replacing property, plant and equipment. The company's ability to react to inflation depends on, among other things, its ability to compensate for increased costs with increased sales prices, the extent to which productivity can be increased and its method of financing the enterprise.

The Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) have established standards for reporting the effects of inflation. These standards require supplemental disclosures to conventional financial statements prepared in accordance with generally accepted accounting principles.

FASB Statement No. 33, "Financial Reporting and Changing Prices", requires the presentation of a statement of earnings that is derived by restating cost of goods sold, and depreciation and amortization to dollars, whose purchasing power is equivalent to the dollar for fiscal year ending February 28, 1981, as measured by the Consumer Price Index for All Urban Consumers (CPI-U) (the Constant Dollar method). The CPI-U is an index used to measure the average change in prices over time of consumer durable and non-durable goods and services.

Under the Constant Dollar method, cost of sales are adjusted to a common unit of measure. The adjustment to cost of sales reflects a charge for inflation for the period inventory was held prior to sale. Cost of sales is restated for changes in the levels of inventories priced under the FIFO method of inventory valuation.

The adjustment to depreciation reflects a charge for inflation from the period in which plant and equipment were purchased to the present. Depreciation was computed using the same depreciation methods and depreciable life assumptions utilized for the conventional financial statements.

The FASB, in Statement No. 33, encourages "experimentation within the guidelines of this statement and the development of new techniques that fit the particular circumstances of the enterprise." Management supports this experimentation and feels that more emphasis on financial data adjusted for the effects of inflation on a particular enterprise may provide financial statement users a more reliable basis for comparison among companies within the same industry.

The company recognizes that inflation has had a severe impact on the reported figures; however, the company also believes that the CPI-U can produce results as misleading as the historic figures presented in the financial statements. Accordingly, the disclosures of certain information in accordance with FASB Statement No. 33 was prepared using the CPI-U as it relates to the respective segments of the company. However, since the FASB could not assure the company that the SEC would accept these computations, a dual presentation is made also showing the effect of using the CPI-U for all industries, including those in which the company does not compete.

Current cost measures the effect of specific price changes on inventory, and property, plant and equipment as a result of inflation. The current cost of inventories owned is the current cost of purchasing the goods concerned or the current cost of the resources required to produce the goods concerned. The current cost of inventories was determined utilizing the FIFO method of inventory valuation adjusted for unrecognized price increases through application of the Bureau of Labor Statistics Producer Price Index (BLS-PPI) for those inventory items applicable to the company.

The current cost of property, plant, and equipment was determined using the appropriate BLS-PPI, the Marshall Valuation Service Building Cost Index, and management's estimates and appraisals. The current cost of property measures costs of assets having the same or similar service potential as those owned by the company. Current cost does not measure owned assets against those technologically superior assets which may be available and which also may require capital outlays significantly greater than the current costs of assets presently owned by the company.

The purpose of current cost restatement is to provide management with a basis for estimating the impact of price changes on future net income and potential cash flow. However, current cost data does not reflect specific plans for replacement of property, nor does it purport to represent precise measurements of assets and expenses, but rather approximations of price changes experienced by the company.

The adjustment to cost of sales was determined on the same basis as calculated for constant dollars. The adjustment reflects the change in beginning and ending inventory levels as adjusted for increases in specific prices of inventory.

The adjustment to depreciation reflects the increased expense associated with the current cost valuation of property, plant, and equipment. Depreciation was computed using the same depreciation methods and depreciable life assumptions utilized for the conventional financial statements.

Inflation also affects monetary assets, such as cash and receivables, and monetary liabilities, such as debt, payables, and deferred income taxes. Any company in a net monetary borrowing position can benefit during periods of inflation because dollars with lower purchasing power will be used to satisfy obligations in future years. Holding monetary assets in a period of inflation results in a purchasing power loss.

The five-year comparison shows the effect of adjusting required historical data for the effects of inflation on both a constant dollar and current cost basis. Constant dollar cost is presented showing the results of using the CPI-U for all industries and again using the CPI-U as it relates to the specific segments of the company.

The provision for income taxes remains unchanged because income tax laws do not allow the company to claim tax deductions related to these adjustments. As a result, the adjustments made for inflation are not tax effected. Thus, the effective tax rates and net earnings on an inflation adjusted basis are distorted.

All comparisons between the conventional financial statements and the required supplemental disclosures must be viewed with caution because of the many assumptions inherent in these estimates.

The summary consolidated statement of earnings adjusted for inflation for the year ended February 28, 1981, is as follows:

	As Reported In Financial Statements (Historical Dollars)	Adjusted for General Inflation (Constant Dollars) Company Segments	Adjusted for General Inflation (Constant Dollars) All Industries	Adjusted For Specific Price Changes (Current Cost)
Net sales and other income	$2,395,875	$2,395,875	$2,395,875	$2,395,875
Cost of sales (a)	1,580,686	1,610,042	1,642,851	1,615,465
Selling, general and administrative expenses (a)	523,943	523,943	523,943	523,943
Depreciation expense	32,845	40,481	47,187	57,018
Interest expense	20,284	20,284	20,284	20,284
Income taxes	113,787	113,787	113,787	113,787
	2,271,545	2,308,537	2,348,052	2,330,497
Net earnings	$ 124,330	$ 87,338	$ 47,823	$ 65,378
Earnings per share	$ 7.61	$ 5.34	$ 2.93	$ 4.00
Effective income tax rate	47.8%	56.6%	70.4%	63.5%
Gain in purchasing power of net monetary assets held			$ 10,923	$ 10,923
Effect of increases in general price level				$ 159,830
Increases in specific prices (current cost) of inventory and property, plant and equipment(b)				110,308
Excess of increase in general price level over increase in current cost				$ 49,522

(a) Excludes depreciation and amortization expense.

(b) The current cost of inventory was $601,935 at February 28, 1981 and $624,446 at February 29, 1980. The current cost of property, plant and equipment, net of accumulated depreciation and amortization, was $685,514 at February 28, 1981 and $543,030 at February 29, 1980.

Notes to Consolidated Financial Statements

(*Continued*)

The following five-year comparison shows selected historical financial data adjusted for the effects of changing prices:

	1981	1980	1979	1978	1977
Net sales and other income:					
Historic dollars	$2,395,875	$2,048,267	$1,870,961	$1,683,282	$1,582,415
Constant dollars:					
Company segments	2,395,875	2,202,011	2,104,387	1,951,377	1,904,044
All industries	2,395,875	2,316,394	2,370,764	2,306,142	2,312,902
Net earnings:					
Historic dollars	124,330	106,706			
Constant dollars:					
Company segments	87,338				
All industries	47,823	38,517			
Current cost	65,378	76,744			
Earnings per share:					
Historic dollars	7.61	7.35			
Constant dollars:					
Company segments	5.34				
All industries	2.93	2.65			
Current cost	4.00	5.28			
Cash dividends declared per common share:					
Historic dollars	2.64	2.35	2.10	1.85	1.62½
Constant dollars — all industries	2.64	2.66	2.66	2.53	2.38
Net assets at year end:					
Historic dollars	914,000	836,313			
Constant dollars — all industries	1,139,464	1,076,985			
Current cost	1,208,951	1,179,406			
Excess of increase in general price level over increase in current cost	49,522				
Gain (loss) in purchasing power of net monetary assets	10,923	(1,253)			
Market price — end of year:					
Historic dollars	49.38	38.00	37.25	39.25	40.50
Constant dollars — all industries	$49.38	$42.97	$47.20	$53.77	$59.20
Average Consumer Price Index:					
Composite of company segments	177.6	165.2	157.9	153.2	147.6
All industries	251.4	222.3	198.4	183.5	172.0

18. Quarterly Financial Information (Unaudited)

The following quarterly information includes all adjustments necessary for a fair presentation:

	First	Second	Third	Fourth
Sales				
1981	**$532,392**	**$599,125**	**$606,949**	**$629,990**
1980	463,789	532,143	519,217	509,158
1979	412,651	485,964	502,200	450,643
Gross Profit				
1981	**$166,535**	**$190,318**	**$198,016**	**$222,228**
1980	140,352	157,691	162,763	183,733
1979	125,498	144,599	155,678	159,065
Net Earnings				
1981	**$23,025**	**$29,778**	**$33,006**	**$38,521**
1980	19,761	25,344	28,251	33,350
1979	17,374	21,476	26,136	27,590
Earnings Per Share				
1981	**$1.41**	**$1.82**	**$2.02**	**$2.36**
1980	1.37	1.76	1.98	2.24
1979	1.20	1.47	1.80	1.90
Common Dividends Paid Per Share				
1981	**$0.66**	**$0.66**	**$0.66**	**$0.66**
1980	0.55	0.60	0.60	0.60
1979	0.50	0.50	0.55	0.55

Independent Accountants' Report

The Board of Directors and Stockholders
INTERCO INCORPORATED:

We have examined the consolidated balance sheets of INTERCO INCORPORATED and subsidiaries as of February 28, 1981 and February 29, 1980 and the related consolidated statements of earnings, stockholders' equity, and changes in financial position for each of the years in the three year period ended February 28, 1981. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of INTERCO INCORPORATED and subsidiaries at February 28, 1981 and February 29, 1980 and the results of their operations and the changes in their financial position for each of the years in the three year period ended February 28, 1981, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

St. Louis, Missouri
April 13, 1981

Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations

Fiscal 1981 represented the first full year of operations for the Furniture and Home Furnishings Group which includes Ethan Allen acquired on January 28, 1980 and Broyhill acquired on December 1, 1980. These acquisitions were accounted for as purchases; and, accordingly, their operations have been included in the consolidated statements from their respective dates of acquisition.

Sales — During the past three years, net sales have increased 17.0%, 9.3% and 11.1%, respectively. Each major operating group contributed to the increases with record sales. The primary reason for the 17.0% increase in fiscal 1981 was due to the inclusion of the Furniture and Home Furnishing Group for the year.

Cost of Sales and Selling, General and Administrative Expenses — Costs of sales and expenses remained relatively constant as a percent of sales, and for the past three years were 90.2%, 90.6% and 90.4%, respectively. Over the years, the company has been able to compensate for increases in costs and expenses through the cost control programs and increased selling prices.

Interest Expense — Interest expense increased to $20.3 million in fiscal 1981 from $9.3 million in fiscal 1980, which decreased slightly from the $9.6 million in fiscal 1979. The increase in fiscal 1981 was attributable to the assumed debt of the purchased companies, an increased level of short-term borrowing, at higher rates, to finance operational needs and the issuance of new debt.

Net Earnings — Net earnings have increased 16.5%, 15.3% and 13.1% during the past three years, respectively. Earnings of the manufacturing segments of the company have continued to improve over the three-year period while earnings of the general retail segment were affected by above normal markdowns and the higher cost of doing business.

Earnings Per Share — Fully diluted earnings per share were $7.61, an increase of 3.5% from $7.35 in fiscal 1980, after increases of 15.4% and 11.8% in the two previous years, respectively.

The increase in fiscal 1981 was less than the increase in net earnings due to the inclusion in average shares outstanding of the common stock equivalents of the preferred stock issued for the acquired company. In fiscal 1980, average shares were reduced by treasury shares purchased and increased by the common stock equivalents of the preferred stock, which was in the average for one month, thus producing a slightly higher increase in per share earnings as compared to the net earnings increase. The percentage increase in fiscal 1979 was less than the net earnings increase due to a larger number of shares outstanding.

Financial Condition

Working Capital and Debt — Working capital was $714.7 million at the end of fiscal 1981 as compared to $606.8 million at February 29, 1980. The current ratio was 3.7 to 1 at February 28, 1981 as compared to 3.5 to 1 the prior year.

Additions to long-term debt and capital lease obligations amounted to $142.5 million in fiscal 1981 and $5.1 million in fiscal 1980. Debt and obligations assumed in the purchase of Broyhill and Ethan Allen amounted to $6.6 million and $41.1 million in fiscal 1981 and 1980, respectively.

The principal increases for fiscal 1981 in long-term debt were the 10% promissory notes for $43.6 million issued in the purchase of Broyhill, and the $80.3 million in commercial paper which is scheduled for redemption through the issuance of the $100 million in 14¼% promissory notes.

To meet short-term working capital requirements, the company maintains a credit agreement enabling it to borrow up to $100 million in domestic or Euro-Dollar loans through February 28, 1983. The company also maintains other bank lines of credit, aggregating $90 million, as credit availability and support for the sale of commercial paper.

Capital Expenditures — The company maintains formalized procedures for the review of capital expenditures to include its projected return on investment.

Capital expenditures, for company owned and capitalized leased property, aggregated $227.3 million during the last five years, of which $68.7 million occured in fiscal 1981. It is anticipated that capital expenditures for fiscal 1982 will approximate $59 million, of which $15 million represented firm commitments at February 28, 1981.

Inflation Accounting — In Note 17 of the Notes to Consolidated Financial Statements, the company reports on Inflation Accounting based on the Consumer Price Index for all Urban Consumers as required under Financial Accounting Standards Board Statement No. 33. In addition, the effect of inflation is also presented based on the Consumer Price Index as it relates to the respective segments of the company.

Five Year Consolidated Financial Review

(Dollars in thousands except per share data)

Years Ended	**1981**	1980	1979	1978	1977
For The Year					
Summary of operations:					
Net sales	**$2,368,456**	$2,024,307	$1,851,458	$1,666,657	$1,566,432
Cost of sales	**1,591,359**	1,379,768	1,266,618	1,158,387	1,094,826
Interest expense	**20,284**	9,316	9,570	8,398	7,766
Earnings before income taxes	**238,117**	205,735	186,869	161,579	149,392
As a percent of sales	**10.1%**	10.2%	10.1%	9.7%	9.5%
Income taxes	**113,787**	99,029	94,293	79,745	73,122
Net earnings	**124,330**	106,706	92,576	81,834	76,270
As a percent of sales	**5.2%**	5.3%	5.0%	4.9%	4.9%
Earnings applicable to common stock	**124,399**	106,719	92,576	81,834	75,541
Per share of common stock:					
Fully diluted earnings	**$7.61**	$7.35	$6.37	$5.70	$5.32
Dividends	**$2.64**	$2.35	$2.10	$1.85	$1.62½
Average common and common equivalent shares outstanding (in thousands)	**16,344**	14,527	14,535	14,365	14,324
Cash dividends paid:					
On common stock	**$ 37,042**	$ 33,563	$ 30,425	$ 26,490	$ 21,998
On preferred stock	**$ 7,511**	$ —	$ —	$ 1	$ 729
At Year End					
Working capital	**$ 714,678**	$ 606,833	$ 537,878	$532,361	$481,156
Property, plant and equipment, net	**412,107**	309,636	207,641	180,591	174,170
Capital expenditures:					
Company owned property	**62,857**	41,849	30,173	19,980	26,006
Capitalized leased property	**5,860**	4,759	16,427	9,227	10,208
Total assets	**1,469,137**	1,239,036	1,003,075	899,778	819,360
Long-term debt	**187,208**	60,225	41,236	42,825	46,138
Obligations under capital leases	**79,925**	80,718	68,146	58,325	54,056
Stockholders' equity	**914,000**	836,313	684,164	621,512	565,178
Book value per common share	**$ 57.98**	$ 52.21	$ 47.56	$ 43.34	$ 39.72

The above figures have been restated for the retroactive restatement of capital leases at February 28, 1977.

Tribute To M. R. Chambers

On the occasion of his retirement, effective June 22, 1981, as a Director and as Chairman of the Executive Committee of INTERCO INCORPORATED, the management and Board of Directors of the company wish to honor and pay tribute to M. R. "Dude" Chambers for his many years of service both to INTERCO and to the community.

Mr. Chambers joined International Shoe Company in 1949 as divisional sales manager. He was named Vice President of Footwear Sales in 1956, a Director in 1957, and was elected President in 1962. Mr. Chambers was elected Chairman of the Board and President of INTERCO in 1965, and Chairman and Chief Executive Officer in 1970. Mr. Chambers relinquished his Chief Executive positions in 1976, and has continued to serve the company as a Director and Chairman of the Executive Committee.

During the years following his election as President, Mr. Chambers planned and guided a diversification and reorganization of the company which has resulted in INTERCO becoming a major factor in the industries in which the company competes.

In addition to his many contributions to the company, Mr. Chambers has served as a director of numerous civic and philanthropic organizations. In recognition of his leadership, Mr. Chambers has received a number of awards including the St. Louis Globe-Democrat's "Man of the Year" award in 1971, and the Financial World Magazine designation as "Chief Executive Officer of the Year" in 1976.

In recognition of his many contributions to the growth and success of the company, it will be recommended that, upon his retirement, Mr. Chambers be elected an Honorary Director of INTERCO INCORPORATED.

Directors, Officers and the Operating Board

Board of Directors

Nathan S. Ancell
Chairman of the Board, Ethan Allen Inc.

Ronald L. Aylward
Executive Vice President, Administrative, of the Company

Zane E. Barnes
President and Chief Executive Officer, Southwestern Bell Telephone Company

Maurice R. Chambers
Chairman of the Executive Committee of the Company

Stanley M. Cohen
President, Central Hardware Company

William L. Edwards, Jr.
Chairman of the Board and Chief Executive Officer of the Company

Edwin S. Jones
Retired

Donald E. Lasater
Chairman of the Board and Chief Executive Officer, Mercantile Bancorporation, Inc. and Mercantile Trust Company National Association

Jonathan P. Myers
Chairman of the Board, Londontown Corporation

Thomas H. O'Leary
President, Missouri Pacific Corporation

Norfleet H. Rand
Retired

John K. Riedy
Vice Chairman of the Board of the Company

Charles J. Rothschild, Jr.
President, Campus Sweater & Sportswear Company

Harvey Saligman
President and Chief Operating Officer of the Company

Executive Committee

Maurice R. Chambers, Chairman
Ronald L. Aylward
William L. Edwards, Jr.
Norfleet H. Rand
John K. Riedy

Audit Committee

Thomas H. O'Leary, Chairman
Zane E. Barnes
Edwin S. Jones
Donald E. Lasater

Executive Compensation and Stock Option Committee

Donald E. Lasater, Chairman
Zane E. Barnes
Edwin S. Jones
Thomas H. O'Leary
Norfleet H. Rand

Corporate Officers

William L. Edwards, Jr.
Chairman of the Board and Chief Executive Officer

John K. Riedy
Vice Chairman of the Board

Harvey Saligman
President and Chief Operating Officer

Ronald L. Aylward
Executive Vice President, Administrative

Stanley M. Cohen
Vice President

Gerald B. Hirsch
Vice President

Jonathan P. Myers
Vice President

J. Carl Powers
Vice President

Charles J. Rothschild, Jr.
Vice President

Nathan S. Ancell
Vice President

Duane A. Patterson
Secretary

Robert T. Hensley, Jr.
Treasurer
Stanley F. Huck
Controller
Keith E. Mattern
Assistant Secretary
James K. Pendleton
Assistant Secretary
William R. Withrow
Assistant Treasurer
Russell L. Baumann
Assistant Controller
Wilfred G. Morice
Assistant Controller — Manager of Internal Auditing

Operating Board

William L. Edwards, Jr.
Chairman of the Board and Chief Executive Officer of the Company
John K. Riedy
Vice Chairman of the Board of the Company
Harvey Saligman
President and Chief Operating Officer of the Company
Ronald L. Aylward
Executive Vice President, Administrative, of the Company
Nathan S. Ancell
Chairman of the Board, Ethan Allen Inc.
Edwin J. Baum
President, The Biltwell Company, Inc.
Lionel Baxter
President, Big Yank Corporation
Paul H. Broyhill
Chairman of the Board, Broyhill Furniture Industries, Inc.
Stanley M. Cohen
President, Central Hardware Company
Webster L. Cowden, Jr.
President, Cowden Manufacturing Company
Herschel Cravitz
President, Queen Casuals, Inc.
Theodore A. Fell
President, Sidney Gould Co., Ltd.
Barry S. Fine
President, Fine's Men's Shops, Incorporated and Standard Sportswear
Jean S. Goodson
President, International Hat Company
Gerald B. Hirsch
President, P. N. Hirsch & Company
William B. Klinsky
President, Alberts, Inc.
Harry M. Krogh
President, The Florsheim Shoe Company
Stanley Matzkin
President, Devon Apparel
Jonathan P. Myers
Chairman of the Board, Londontown Corporation
Myron C. Peterson
Chairman of the Board and President, Sky City Stores, Inc.
J. Carl Powers
President, International Shoe Company
Charles J. Rothschild, Jr.
President, Campus Sweater & Sportswear Company
Arthur Sibley
President, College-Town
Irving S. Wahl
Chairman of the Board, Stuffed Shirt/Stuffed Jeans, Inc.
John Weil
President, Eagle Family Discount Stores, Inc.

Principal Companies of INTERCO

Apparel Manufacturing Group

Big Yank Corporation
New York, New York

The Biltwell Company, Inc.
St. Louis, Missouri

Campus Sweater & Sportswear Company
Paramus, New Jersey

College-Town
Braintree, Massachusetts

Cowden Manufacturing Company
Lexington, Kentucky

Devon Apparel
Philadelphia, Pennsylvania

International Hat Company
St. Louis, Missouri

Londontown Corporation
Eldersburg, Maryland

Queen Casuals, Inc.
Philadelphia, Pennsylvania

Sidney Gould Co., Ltd.
Garden City Park, New York

Stuffed Shirt/Stuffed Jeans, Inc.
New York, New York

General Retail Merchandising Group

Alberts, Inc.
Detroit, Michigan

Central Hardware Company
St. Louis, Missouri

Eagle Family Discount Stores, Inc.
Miami, Florida

Fine's Men's Shops, Incorporated
Norfolk, Virginia

Golde's Department Stores, Inc.
St. Louis, Missouri

P. N. Hirsch & Company
St. Louis, Missouri

Sky City Stores, Inc.
Asheville, North Carolina

Standard Sportswear
Pittsburgh, Pennsylvania

United Shirt Distributors, Inc.
Detroit, Michigan

Footwear Manufacturing and Retailing Group

The Florsheim Shoe Company
Chicago, Illinois

International Shoe Company
St. Louis, Missouri

Senack Shoes, Inc.
St. Louis, Missouri

Furniture and Home Furnishings Group

Broyhill Furniture Industries, Inc.
Lenoir, North Carolina

Ethan Allen Inc.
Danbury, Connecticut

Stockholder Information

Transfer Agents
(Common and Preferred Stock)
Manufacturers Hanover Trust Company
New York, New York
(212) 623-3157
Mercantile Trust Company National Association
St. Louis, Missouri
(314) 425-2755

Registrars
(Common and Preferred Stock)
Morgan Guaranty Trust Company
New York, New York
(212) 483-2323
St. Louis Union Trust Company
St. Louis, Missouri
(314) 231-9300

Dividend Disbursing Agent
(Common and Preferred Stock)
Mercantile Trust Company National Association
St. Louis, Missouri
(314) 425-2755

Independent Accountants
Peat, Marwick, Mitchell & Co.
St. Louis, Missouri 63101

Exchange Listings
Common and Preferred shares are listed on the New York Stock Exchange. Common shares are also listed on the Midwest Stock Exchange.
(Trading symbol: ISS)

Corporate Offices
Ten Broadway
St. Louis, Missouri 63102
(314) 231-1100

Mailing Address:
Post Office Box 8777
St. Louis, Missouri 63102

Annual Meeting
The Annual Meeting of Stockholders will be held at 10 a.m., Monday, June 22, 1981, at the Marriott Pavilion Hotel, One Broadway, St. Louis, Missouri. Notice of the meeting and a proxy statement will be sent to stockholders in a separate mailing.

INTERCO INCORPORATED
St. Louis, Missouri